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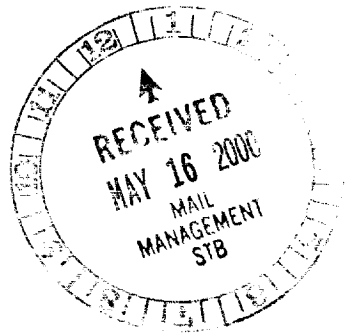

May 16, 2000

HAND DELIVERY

Surface Transportation Board
Office of the Secretary
Case Control Unit
Attn: STB Ex Parte No. 582
1925 K Street, N.W.
Washington, DC 20423-0001

Re: Ex Parte No. 582 (Sub-No. 1), Major Rail Consolidation Procedures

Dear Ladies/Gentlemen:

Enclosed please find an original and 25 copies of Comments on Behalf of the Port Authority of New York and New Jersey in the above-captioned proceeding. In addition, please find a 3.5-inch IBM-compatible floppy diskette convertible into 7.0 WordPerfect of the same document.

Very truly yours,

Paul M. Donovan

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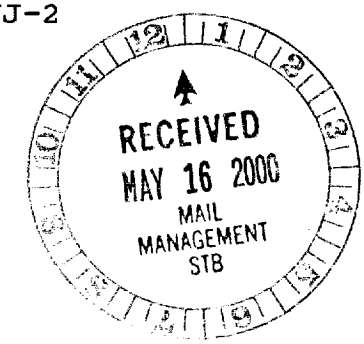
NY/NJ-2



BEFORE THE
SURFACE TRANSPORTATION BOARD

EX PARTE NO. 582 (Sub-No.1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS ON BEHALF OF THE
PORT AUTHORITY OF NEW YORK AND NEW JERSEY

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DATED: May 16, 2000

manner. The efficacy of those investments is obviously threatened by rail services that do not meet the needs of those who would use the Port.

In these comments, the Port Authority will present several suggested modifications to Part 1180 of the Board's consolidation regulations, and will otherwise address those issues raised by the Board in its order of March 31, 2000. At the outset, however, one overriding change must be made in the Board's current policy statement found in 49 CFR 1180.1. Currently, that section begins: "The Surface Transportation Board encourages private industry initiatives that lead to the rationalization of the nation's rail facilities and reduction of excess capacity." The major problem faced by the Port Authority, and others requiring rail service within the Port District, is a lack of rail infrastructure. The situation that exists today is quite obviously dramatically different than that faced by the rail carriers when the current consolidation procedures were adopted.

The precarious financial condition of Norfolk Southern ("NS") and CSX severely restrict the ability of those carriers to make the investments in rail infrastructure that are required to improve the service now being provided to, from and within the Port District. This financial condition is a direct result of the acquisition of Conrail and the inability of the Board under existing consolidation procedures to anticipate the financial consequences of the huge premium paid for Conrail by the competitively bidding acquirers. Private industry initiatives are not

always in the public interest, and it is unwise to assume that they are. Yet the public interest is one issue that the Board is charged with considering.

The current consolidation procedures seem to presume that rail consolidations are in the public interest, and that may have been true when those procedures were adopted. Today, however, given the substantial concentration in the rail industry, and the limited opportunity for reducing excess rail capacity, there seems to be no valid reason for applying such a presumption. In fact, the presumption should be to the contrary.

It could be argued that revising the consolidation procedures is not necessary inasmuch as the Board currently has authority under the statute and under the current procedures to be more restrictive in consolidation applications. That approach would, however, leave the carriers with an unclear understanding of how any future application might be viewed by the Board. Thus, the Port Authority believes that a clear statement of those principles that the Board will employ in any future application should be issued.

The Port Authority suggests that the following amendments be made to the current provisions of Subpart A of Part 1180 of 49 Code of Federal Regulations:

SECTION 1180.1

Subsection 1180.1(a) should be amended to read:

> (a) General. The Surface Transportation Board recognizes that the railroad industry has become highly concentrated, and that further rail consolidations may have the effect of limiting rail competition and reduc-

> ing the adequacy of rail service. The Board favors further rail consolidations only in those circumstances where the involved carriers can affirmatively demonstrate that the consolidation at issue will enhance competition and improve rail service. In making these demonstrations, the carriers must also demonstrate that the competitive enhancements and improved service could not be accomplished by means other than the proposed consolidation.

This revision would reflect the Board's statement in its order of March 31, 2000: "The goals of the merger policy have largely been achieved. It does not appear that there are significant public interest benefits to be realized from further downsizing or rationalizing of rail route systems, as there is little of that activity left to do."

The Port Authority believes that there may or there may not be consolidations in the future that will enhance competition and improve service. But, given the current concentrated rail market, and given the financial situation facing a large portion of the industry today, the burden of establishing that any proposed consolidation is in the public interest must be much heavier than in the past. Simple assertions that industry knows best, or that private initiatives are presumed beneficial to the nation have not been borne out by the recent past.

It must be presumed that private initiatives are designed to produce private benefits. That is not to say that private parties cannot, and do not, engage in activities that are beneficial to the public interest. But, it cannot be assumed that they are.

Subsection 1180.1(b) should be amended to read:

(b) Consolidation criteria. The Board's consideration of the merger or control of at least two class I railroads is governed by the criteria prescribed in 49 U.S.C. 11324 and by the rail transportation policy set forth in 49 U.S.C. 10101.

(1) Section 11324 directs the Board to approve consolidations that are consistent with the public interest. In examining a proposed transaction, the Board must consider, at a minimum:

(i) The effect on the adequacy of transportation to the public;
(ii) The effect of including, or failing to include, other rail carriers in the area involved in the proposed transaction;
(iii) The total fixed charges that would result;
(iv) The interest of affected carrier employees;
(v) The effect on competition among rail carriers, and the effect on competitive alternatives available to shippers throughout the nation's rail system;
(vi) The effect on other entities including communities, ports and commuter railroads; and
(vii) Whether the benefits claimed by proponents of the proposed consolidation could be achieved by means other than consolidation.

(2) The Board must also consider the impact of any transaction on the quality of the human environment, the conservation of energy resources, and safety of the nation's rail system.

The revisions to subparagraph (b) are designed to make it clear that in today's concentrated rail transportation industry, the loss of alternative routes, whether through parallel mergers or end-to-end mergers involves substantial anticompetitive risks. Thus, any consolidation that reduces competitive alternatives must be viewed with suspicion even though it fits the classic definition of an end-to-end transaction.

The revisions would also broaden the parties recognized to

be potentially affected by consolidations to include communities, ports and commuter rail service providers. While the Board has recognized the interests of these parties on a case by case basis they have not specifically been mentioned in the consolidation criteria.

> (c) Public interest considerations. In determining whether a transaction is in the public interest, the board performs a balancing test. It weighs the benefits to the public against the potential harm to the public. The Board will consider whether the benefits to the public claimed by the applicants could be realized by means other than the proposed consolidation, and if those alternative means would result in less potential harm to the public.
>
> (1) Potential benefits. In determining the benefits from a proposed consolidation, the Board will confine its inquiry to those benefits that accrue to the public. To the extent that certain elements of the consolidation would benefit both the public and the applicants, the Board will determine which of those benefits could be accomplished by actions other than consolidation, and shall consider as public benefits only those elements that could not be so accomplished.
>
> (2) Potential harm. The potential harm to the public interest that may result from rail consolidations include reduction in rail competition, and reduction in the level and quality of rail services available to the public. The Board will look with disfavor upon any proposed consolidation that involves either of these two public harms.
>
> (i) Reduction of competition. If two carriers serving the same market consolidate, the result would be the elimination of the competition between the two. Even if the consolidating carriers do not serve the same market directly, their consolidation could nonetheless reduce competition by removing competitive alternatives and limiting the available routes over which shippers may seek to move traffic. The reduction of available routes may also force traffic to move over routes most favorable from the point of view of the consolidating carriers, but not in the interest of shippers, communities or ports. Given the concentration of the rail industry, any

> proposed transaction that would reduce the competitive alternatives, or permit consolidating carriers to reduce those alternatives in the future, will be looked upon with disfavor by the board.
> (ii) Harm to essential service. In the past, the Board took the view that its role in consolidations was the preservation of essential services, not the survival of particular carriers. Today, however, it is almost impossible to construct a scenario where a rail carrier would be imperiled and not reduce essential services, or limit competition. In addition, reducing costs by reducing infrastructure or capacity will no longer be viewed as a public benefit. To the extent that proponents of a consolidation seek to reduce costs by reducing capacity, they will bear a heavy burden to demonstrate that the reduction does not result in harm to essential rail services.

The public interest considerations have been amended to reflect the fact that rail consolidations can no longer be presumed to be in the public interest simply because they are perceived, by the proponents at least, as being in the interests of the consolidating carriers. As will be discussed more fully below, the public interest today is inextricably bound to the health of the entire rail system, not merely to the financial success of a carrier or a combination of carriers.

The several consolidations that have occurred since passage of the Staggers Rail Act have dramatically reduced the number of rail carriers and the available rail infrastructure. These consolidations, coupled with the other Staggers Act reforms, have improved the rail industry's health. It cannot be ignored, however, that the improved financial health of the industry has come concomitantly with a drastic downsizing in its relative

economic importance. Operating revenues have declined 37.1 percent in real terms from 1980 to 1998. In the same period, the real U.S. GDP increased 63.6 percent. The share of GDP represented by rail revenues had, in 18 years, declined to 38 percent of the 1980 level. Every ton-mile moved by the railroads is worth less and less. This is why railroads are unloved by Wall Street. Where is the revenue growth potential? Without growth, it is difficult to attract capital. With capital scarce, infrastructure and capacity problems should not be unexpected.

In light of this sorry picture, it is difficult to imagine the justification for further contraction of rail infrastructure through consolidations. Thus, rail consolidation procedures should be amended to reflect today's situation, and the above amendments are designed to accomplish that result.

A new Subsection 1180.1(d) should be added to provide:

> (d) Downstream effects. The Board recognizes that its statutory responsibility is to protect the public interest, and not to protect or promote the interests of individual carriers when to do so would potentially harm the public interest. In any proposed consolidation proceeding, the Board will consider the likely "downstream" effects of approval of the proposed application including, but not limited to the likely responses of other rail carriers to the proposed consolidation. To the extent that such likely responses would potentially harm the public interest, the Board shall give the same weight to that harm as it would to harm directly resulting from the proposed consolidation. In determining the likely responses, the Board will seek the direct testimony of the potentially responding carriers, but will make its determination as to likely responses and their consequences based upon the totality of the facts and circumstances surrounding the rail industry at that time.

This new subsection is designed to allow the Board to weigh

all of the factors and circumstances that would likely follow from a new consolidation in the rail industry. While it may seem harsh to view a consolidation application through the prism of likely downstream effects, to do otherwise is in reality to continue the "one case at a time" process that the Board has recognized is no longer an acceptable procedure.

In addition, the new subsection permits the Board to make a broad inquiry into the most likely downstream effects without being constrained to accept the testimony of interested carriers at face value. The subsection anticipates that the Board would require meaningful corroboration before relying upon such testimony.

> The current Subsection (d) should be redesignated as Subsection (e) and amended to read:
>
> (e) Conditions. The Board has broad authority to impose conditions on consolidations, including those that would enhance competition and those that would preserve essential rail services. The Board will use its conditioning authority to protect and promote the public interest both in connection with the pending transaction and to protect against public injury as a result of downstream effects.

The revisions to the new subsection (e) merely reflect the broad authority of the Board to impose such conditions as may be necessary to protect and promote the public interests as those interests are outlined in the rest of the section as a whole. There would appear to be no good reason to limit that authority in any manner that is not otherwise limited by statute. Given the provisions of the new subsection (d) regarding downstream effects, the Board must also be free to impose conditions necessary

to deal with negative downstream consequences.

> Subsection (e) Inclusion of other carriers, and Subsection (f) Labor protection should be redesignated as subsections (f) and (g) respectively, and otherwise remain unchanged.
>
> Subsection (g) Cumulative impacts and crossover effects should be eliminated.

The current subsection is plainly at odds with the new subsection (d) dealing with downstream effects. Accordingly, it should be removed.

> Subsection (h) Public participation should remain unchanged.

SECTION 1180.6

The changes suggested by the Port Authority to the criteria contained in Section 1180.1 would require significant changes in Section 1180.6 regarding the information that applicants must file in support of any consolidation application. The Port Authority will not now attempt to delineate those changes other than to note that applicants, or others attempting to demonstrate downstream effects, should be required to present probative material and testimony, subject to meaningful cross-examination, and not be permitted to rely upon opinion and conclusions to satisfy their burden of proof.

In past consolidation proceedings, the Board has been hindered in its deliberations because no objective fact finder has been present during the development of the record. The Port Authority is sensitive to the limited resources of the Board. However, if the public interest is to be preserved and promoted, the Board should devote sufficient resources to consolidation

proceedings to insure that the credibility of obviously biased witnesses can be fairly tested, and that an Administrative Law Judge be present during that testing.

Similarly, the abuses of "Confidential" and "Highly Confidential" designations, and restrictive access to information effectively to hide materials that are potentially damaging to applicants has risen to an art form. The use of these designations, under the supervision of an Administrative Law Judge would permit all parties to develop a more meaningful record for the Board.

The Port Authority recognizes that the above-noted procedural issues are not strictly a part of this proceeding. However, the procedures that now exist seem to follow from an attitude that almost presumes that every consolidation is in the public interest. Given the tone and substance of the Board's orders herein, it would appear to the Port Authority that future consolidation applications should be reviewed without such a presumption operating.

SECTIONS 1180.7 and 1180.8

Section 1180.7, Market Analyses and Section 1180.8, Operational Data should each be amended to provide that the information presented will be closely reviewed by the Board to insure that it is consistent and credible. In the past, traffic projections have not always been matched against infrastructure limitations or other constraining conditions.

For example, in the Conrail proceeding, Applicants presented

considerable information showing substantial increases in intermodal traffic moving from the South into the North Jersey Shared Asset Area. At the same time, Applicants' operating plan, particularly as reviewed by the Port Authority, showed a lack of rail infrastructure within the Shared Asset Area, and certain operational difficulties. These inconsistencies were not noted by the Board. We have all witnessed the operational problems faced by the carriers in the North Jersey Shared Asset Area.[1]

Over time the operating problems we now face will most likely be corrected, but a more stringent reality check during the review and approval process could have prevented, or substantially reduced these problems at the outset.

SECTION 1180.9

The information currently required by Section 1180.9 is sufficient to permit the Board to examine the financial impact of the proposed transaction. However, in most instances, such as the Conrail proceeding for example, the transaction has become a financial fait accompli before the information is ever submitted to the Board.

In the Conrail matter, NS and CSX were paying $10.4 billion in cash for Conrail. That cash payment left NS with long term debt in excess of $7 billion and CSX with long term debt in

[1]By the above commentary, the Port Authority does not want to leave the impression that the carriers have not worked diligently to overcome these operational problems, or that they have not been cooperating with the Port Authority in this regard. To the contrary, the Port Authority and NS, CSX and the CSAO meet regularly and are addressing these problems.

excess of $6 billion. The Port Authority, among others, noted that neither NS nor CSX would likely have sufficient post transaction resources to make the infrastructure investments necessary to provide adequate service to the public.[2]

While everyone could see that NS and CSX were going to be financially strapped after the Conrail acquisition, there seemed to be nothing that anyone could do about it. The financial transaction was completed before the application was submitted to the Board. At that stage, disapproval of the transaction, or the application of capital investment conditions, would have been extremely difficult, perhaps impossible.

What then can the Board do to prevent imprudent financial transactions before they occur? This is a particularly important issue now when competitive responses to the announced BNSF/CN transaction can be anticipated.

The Port Authority suggests that the Board amend Section 1180.9 to require detailed financial information before it approves any voting trust that would allow the consolidation to go forward to financial conclusion. The Board should require that this information disclose, with reasonable certainty, that the proposed transaction would not undermine the ability of the surviving carrier(s) to have or raise sufficient debt and capital

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[2]The result of the financial transaction was, of course, to take $10.4 billion in available cash and credit out of the rail industry in the East, and award that money to those who had speculated in Conrail stock. Many investors must have been pleased, but the segment of the public dependent on rail transportation was not well served.

BEFORE THE
SURFACE TRANSPORTATION BOARD

STB EX PARTE NO. 582 (Sub-No.1)

MAJOR RAIL CONSOLIDATION PROCEDURES

COMMENTS ON BEHALF OF THE
PORT AUTHORITY OF NEW YORK AND NEW JERSEY

INTRODUCTION

The Port Authority of New York and New Jersey ("the Port Authority") is an agency of the States of New York and New Jersey whose bi-state compact was approved by the Congress. Foremost among the statutory responsibilities of the Port Authority is the protection of the commerce of the New York/New Jersey Port District. The Port District, an area defined by law, is roughly a 25-mile radius around the Statue of Liberty. The Port Authority has, over the course of many years, invested hundreds of millions of dollars in port facilities designed to facilitate the flow of export/import traffic through the Port of New York/New Jersey. Foremost among these investments are those to permit rail carriers to serve the Port in a expeditious and efficient

to make necessary investments in the ongoing rail operations. Such a process would alert all involved that the Board will not be forced into approving consolidations because of the economic consequences of its rejection of the application. This procedure may at first blush appear draconian, but there is no other feasible way to protect the public interest in these circumstances.

CONCLUSION

The Port Authority believes that the above-described revisions to Part 1180 would provide the Board with additional tools to protect and promote the public interest in future consolidation proceedings. The Port Authority looks forward to the Notice of Proposed Rulemaking that will follow, and will comment on those proposed rules as appropriate.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have this 16th day of May, 2000, caused the foregoing document to be served upon all parties of record in this proceeding by first class mail, postage prepaid.

Paul M. Donovan